

Letter of Findings 08-0452
Sales and Use Tax
For the Tax Period July 2007-December 2007

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax – Research and Development Exemption.

Authority: IC § 6-8.1-9-1(a)(b); IC § 6-2.5-2-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-40; IC § 6-8.1-5-1(c); Sales Tax Information Bulletin 75 (September 2007); *Indiana Dep't of State Revenue v. Interstate Warehousing*, 783 N.E.2d 248 (Ind. 2003).

The Taxpayer protests the use tax assessment on press guards.

II. Tax Administration - Ten Percent Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2\(b\)\(c\)](#).

The Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

The Taxpayer is an LLC with manufacturing facilities in Indiana. The Taxpayer filed a claim for refund of use taxes paid on research and development equipment used in Indiana during July 2007. After July 2007, the Taxpayer stopped self assessing use tax on research and development equipment used at its Indiana facility. After an investigation, the Indiana Department of Revenue (Department) denied a portion of the claim for refund. The Department also audited the Taxpayer's use tax liability on research and development equipment purchased during the tax period August 1, 2007, through December 31, 2007. Pursuant to the audit, the Department assessed additional use tax, interest, and penalty. The Taxpayer protested the denial of a portion of its claim for refund and the assessment of use tax, interest, and penalty. A telephonic hearing was held and this Letter of Findings results.

ISSUES

I. Sales and Use Tax – Research and Development Exemption.

DISCUSSION

During the tax period July 1, 2007, through July 31, 2007, the Taxpayer purchased materials for its business activities in Indiana. The Taxpayer self assessed use tax on the materials. The Taxpayer requested refunds of the use taxes paid on items that it claimed were used for research and development. The Department denied the request for refund on expensed items. From August 1, 2007, through December 31, 2007, the Taxpayer purchased items for research and development that were expensed without paying sales or use tax on the items. The Department assessed use tax, interest, and penalty on the expensed items. The Taxpayer argued that the Department should refund the use taxes paid on all items purchased in each of these categories during the period July 1 through July 30, 2007. The Taxpayer also protested the assessments of use tax, interest, and penalty for the tax period August 1, 2007, through December 31, 2007.

Taxpayers have the right to file a claim for refund if the Taxpayer thinks it has paid more taxes for a tax period than were legally due. IC § 6-8.1-9-1(a). The claim for refund must include, "the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund." *Id.* In making its determination of whether or not to allow a claim for refund, the Department is required to consider, "[A]ll evidence relative to the claim." IC § 6-8.1-9-1(b).

All tax assessments are presumed to be valid. IC § 6-8.1-5-1(c). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

The Taxpayer described the expensed items as used in the following four categories: test equipment/special tooling purchases from outside vendors, circuit board (solder) stencils, reel holders and circuit board racks, and raw material to make prototypes.

IC § 6-2.5-2-1(a) imposes sales tax on retail transactions made in Indiana. IC § 6-2.5-3-2(a) imposes a complementary use tax on the storage, use or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction as defined for sales tax purposes. A research and development exemption from the sales and use taxes is provided at IC § 6-2.5-5-40 as follows:

(a) As used in this chapter, "research and development activities" does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.

- (6) Research in connection with literary, historical, or similar projects.
- (7) Testing for purposes of quality control.
- (b) As used in this section, "research and development equipment" means "tangible personal property that"
 - (1) consists of or is a combination of:
 - (A) laboratory equipment;
 - (B) computers;
 - (C) computer software;
 - (D) telecommunications equipment; or
 - (E) testing equipment;
 - (2) has not previously been used in Indiana for any purpose; and
 - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or
 - (C) improving or testing existing products.
- (c) A retail transaction:
 - (1) involving research and development equipment; and
 - (2) occurring after June 30, 2007;is exempt from the state gross retail tax.

The Department issued Sales Tax Information Bulletin 75 (September 2007) to provide guidance in interpretation of the research and development exemption. This document describes tangible personal property eligible for the research and development exemption as follows:

Research and development equipment means tangible personal property that consists of laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment that has not previously been used in Indiana for any purpose and is acquired by the purchaser and devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products.

Research and development equipment does not include hand powered tools or property with a useful life of less than one year.

The rules of statutory construction require that exemption statutes be strictly construed against the Taxpayer. *Indiana Dep't of State Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003).

In this situation, the Department applied its policy as stated in Sales Tax Information Bulletin 75 (September 2007) and denied the protested items because they were materials that had a useful life of less than one year and were expensed. The Taxpayer argued that the statute concerning the research and development exemption did not differentiate between capitalized purchases and expensed purchases. The statute, however, sets out five groups of durable equipment that would be capitalized as research and development equipment exempt from the sales tax. The protested items are not durable property such as computers, software programs, laboratory equipment, telecommunications equipment, and testing equipment that will last over one year and be capitalized.

The legislature did not add a category for materials that would be consumed within a year and expensed. Since exemption statutes must be strictly construed against the Taxpayer requesting the exemption, the Department cannot expand the statutory definition of equipment to be used in research and development to include materials to be used and consumed in research and development. Therefore, the protested items do not qualify for the research and development sales tax exemption pursuant to IC § 6-2.5-5-40.

FINDING

The Taxpayer's protest to the denial of portions of the claim for refund and the assessment of use tax is respectfully denied.

II. Tax Administration - Ten Percent Negligence Penalty.

DISCUSSION

The Taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows: Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2](#)(c) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause,

the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The imposition of the negligence penalty is determined on a case by case basis. In this case, the Department has previously denied several of the Taxpayer's identical claims for refund. The Taxpayer was aware of its duty to pay the use tax on the expensed items. The Taxpayer's failure to pay the use tax was a breach of its duty and constitutes negligence.

FINDING

The Taxpayer's protest to the imposition of the penalty is respectfully denied.

CONCLUSION

The Taxpayer's claim for refund is respectfully denied.

The Taxpayer's protest to the imposition of use tax is respectfully denied.

The Taxpayer's protest to the assessment of the penalty is respectfully denied.

Posted: 10/29/2008 by Legislative Services Agency

An [html](#) version of this document.